NOMINATION OF PRESTON MARTIN

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

THE NOMINATION OF

PRESTON MARTIN TO BE A MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM FOR A TERM OF 14 YEARS FROM FEBRUARY 1, 1982; AND TO BE VICE CHAIRMAN OF THE BOARD FOR A TERM OF 4 YEARS FROM THE SAME DATE

MARCH 24, 1982

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NOMINATION OF PRESTON MARTIN

WEDNESDAY, MARCH 24, 1982

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING,
AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10 a.m., in room 5302, Dirksen Senate Office Building, Senator Jake Garn, chairman of the committee, presiding.

Present: Senators Garn, Proxmire, Cranston, and Sarbanes.

OPENING STATEMENT OF CHAIRMAN GARN

The CHAIRMAN. The Banking Committee will come to order.

The purpose of our hearing this morning is to consider the nomination of Preston Martin to be a member and Vice Chairman of the Board of Governors of the Federal Reserve System.

Mr. Martin, we are happy to have you with us this morning. Senator Cranston will be here and would like the privilege of introducing you, so I will go ahead with my opening statement and then when I'm through with that, we will pause until Senator Cranston is here so he can have that privilege.

In the confirmation hearing for Lyle Gramley, I pointed out that with his addition to the Board of Governors of the Federal Reserve System, six of the seven Board members would be individuals who had spent most of their professional lives in Washington or with the Federal Reserve itself.

Paul Volcker was President of the New York Fed. Henry Wallich, while he was a professor at Yale, also worked on the staff of the New York Fed and on the President's Council of Economic Advisers and at the Treasury. Chuck Partee was the Director of Research at the Board of the Governors at the Fed. Nancy Teeters came from staff of the House Budget Committee. Emmett Rice came from a Washington bank. Lyle Gramley came from the President's Council of Economic Advisers and had previously worked at the Board.

Last September I pointed out that the one Governor who did not come from Washington or a Federal Reserve background was Vice Chairman Schultz whose term as Governor was about to expire.

At the time of the Lyle Gramley hearings I considered voting against him. I decided not to and announced in that hearing that it was not fair for me to impose these standards on him when they had not been announced. But I wished to put the Carter administration on notice at that time that any future appointments I would reject without regard to personality if they fit this traditional mold of

inbreeding within the Washington establishment of the Federal Reserve Board.

When President Reagan became President I wanted that message to become loud and clear down at this administration. That was that without regard to personality I would simply try to block the nomination of anyone who fit that traditional mold over the last few years.

So last September, along with Senator Jepsen, I introduced Senate Resolution 209 which called for Governor Schultz' successor to meet the fair representation provision of the Federal Reserve Act providing for agricultural, commercial, including small business, and broad regional representation on the Board of Governors.

There were several proposals that would try to change the makeup of the Fed. I felt that the fair representation provision of the act was already sufficient. It did require broad geographical representation which had been ignored by various means—well, somebody went to college in a particular geographical area or passed through on an airliner and that qualified them.

I felt that with this resolution we would make certain that the Reagan administration would adhere to that fair representation provision.

On December 7 of last year, this committee held a hearing on Senate Resolution 209 and six other resolutions and bills dealing with representation on the Board of Governors and the structure of the Board. That very afternoon the Senate adopted a resolution declaring it to be the sense of the Senate that the next vacancy on the Board of Governors should be filled by an individual who had substantial small business, agriculture, or other small business experience.

Preston Martin, the nominee before the committee today, obviously meets the call for an individual with substantial small business experience. While teaching finance at the University of Southern California, Mr. Martin also ran a consulting firm with fewer than 20 employees from 1954 to 1966. During this same period he was a principal in a small homebuilding firm and financial companies as well.

In 1972, Mr. Martin founded a small company named PMI and certainly I don't believe we can fault you, Mr. Martin, for the fact that this very small company grew into three large companies and that you eventually sold your interest to Sears. You certainly started out small.

While Mr. Martin did serve here in Washington from 1969 through 1972 as Chairman of the Federal Home Loan Bank Board, he clearly is not a product of the Washington Federal Reserve establishment. The vast majority of his career has been spent as a professor of finance and an operator of small businesses.

Thus, Mr. Martin will bring to the Board not only an understanding of the unique problems facing small business but also an invaluable background in the study of monetary economics gained while serving as a professor of finance at the University of Southern California.

A third valuable background which Mr. Martin will bring to the Board is his experience with the problems confronting thrift institutions and the homebuilding industry in general. Not only has he served as Chairman of the Federal Home Loan Bank Board, but

the small businesses he has run have operated in the homebuilding industry.

In nominating Preston Martin as a member of the Board of Governors and as the Board's Vice Chairman, I believe President Reagan has been most responsive to the Senate's concerns over the Board's composition and I believe the President has chosen a man whose background makes him uniquely qualified to serve on the Board at this very difficult time.

Senator Cranston, we would be happy to hear from you.

OPENING STATEMENT OF SENATOR CRANSTON

Senator CRANSTON. Thank you very much, Mr. Chairman.

It's my privilege to introduce Preston Martin, a distinguished citizen from the State of California, to the committee and to recommend him as a member and Vice Chairman of the Board of Governors of the Federal Reserve System.

I have known Preston Martin for many, many years. I can't think of a better, more well-rounded and skilled nominee for a position of this magnitude than Mr. Martin. He brings to this position a very successful background in many walks of life from academic to small business and big business, all of which will be affected by the decisions of the Federal Reserve Board.

Mr. Martin is a graduate of USC, he taught finance there from 1950 to 1965, and has been an important and creative force in the private mortgage insurance business. He founded a small business, as you noted, Mr. Chairman, PMI Mortgage Insurance Co., which grew into a big nationwide business. He's had numerous private business experiences forming his own companies and founding and managing companies of others related to real estate and housing finance.

Additionally, he's had experience at the State and Federal Government level, first as the savings and loan commissioner of the State of California, and then as Chairman of the Federal Home Loan Bank Board. He distinguished his service during this period by engineering the development of the Federal Home Loan Mortgage Corporation, a secondary mortgage facility for savings and loans that has caused millions of units of private housing to be built.

Mr. Chairman, at a time when the housing and savings and loan industries are bearing the brunt of the Federal Reserve's high interest rate policies, a nominee with Mr. Martin's housing and finance background cannot help but bring the sensitivity that he's shown in the past to the present needs of industry that is so vital to the American way of life.

After Mr. Martin was nominated for this position we met. I expressed my concerns about the role of the Fed and the policies of the Fed to him. I did not seek to extract any commitments of any way, shape, or manner in regard to those policies and to that structure, but I think and I know that Mr. Martin is sensitive to the concerns of many of us and many citizens throughout the country about present monetary policy, the present structure whereby our country deals with that, and I think he will, because of that sensitivity, be a very fine member of the Federal Reserve Board.

It's a pleasure to be associated with this nomination and I present him to the committee for confirmation. Thank you very much.

The CHAIRMAN. Thank you, Senator Cranston.

I would also indicate that I had the privilege of having a private conversation with him and trying to sensitize him to some of the feelings of this committee as well. So he's probably been ganged up on from a number of us on this committee.

Senator Hayakawa.

STATEMENT OF SAMUEL ICHIYE HAYAKAWA, U.S. SENATOR FROM THE STATE OF CALIFORNIA

Senator HAYAKAWA. Mr Chairman, it's my pleasure this morning to appear before you to introduce Mr. Preston Martin who is the administration's nominee for the position of Vice Chairman of the Federal Reserve Board.

I had the pleasure of meeting Mr. Martin in my office a few weeks ago to discuss his thoughts on the state of the economy and what approach ought to be taken to bring us into recovery. I have been very much concerned that the nominee for this position be an individual with a broad background not only in academia and finance as so many of the other current and prior Board members have had, but also in business, particularly small business.

I think it is imperative that the body which has some measure of control over the credit availability for businesses have some firsthand insight into the real needs of business. My concerns have been answered in Mr. Martin.

He has vast business experience as a founder of a small business that grew into PMI Mortgage Insurance Co., PMI Insurance Co., and PMI Mortgage Corp. More recently he founded a new Sears company, Seraco Enterprises, which provides capital and oversight of real estate and financial subsidiaries.

These experiences have provided Mr. Martin and will provide the Fed with appreciation for the needs of small businesses both in terms of financing and expectations. I believe the lack of a concrete and demonstrable vision of future credit activity as evidenced in the extreme fluctuations in short-term money figures has been devastating to businesses. It is my hope that Mr. Martin will be able to convince the Board that a roller coaster money supply does not make business happy.

Mr. Martin's other experiences will equally well prepare him for the tasks ahead. He's served as the chairman of the Federal Home Loan Bank Board and as California Savings and Loan commissioner. Both of these positions give Mr. Martin an essential background in government finance and related activity.

Through his private sector experience and his public sector service, I'm sure Mr. Martin will be an asset to the Federal Reserve Board.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Hayakawa. We appreciate you taking the time to come to the committee this morning.

Senator Proxmire.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. Thank you, Mr. Chairman.

Mr. Chairman, you and I come at this from different angles. You're for Preston Martin for one reason and I'm for him for another, but we're both for him and that's what counts. I'm for him exactly because he has the kind of training and background and experience we need on the Federal Reserve Board.

We have the feeling that if somebody hasn't committed a crime and they come from the right State and if he's associated with the right kind of business, he's qualified for the Federal Reserve Board. This is a very complicated operation that requires great expertise, and I think the people on the Federal Reserve Board should hit the ground running. I'm for him because I think he can do exactly that.

He has a degree in economics from Indiana University. He served as a very distinguished chairman of the Home Loan Bank Board, and for a long time I have been pressing hard to get people appointed to public office who have the kind of qualifications for public office that a football coach would have to coach a football team. We'd never dream of appointing somebody to coach the Redskins if he didn't have a solid record as a football coach. If the owner did, he'd be run out of town on a rail.

Well, you have that kind of qualification. Too often we consider somebody whose only background for a job is that he's got opinions. Now he sits on a bar stool somewhere and spouts off. We know all kinds of people that we run into that can solve the world's problems with no background. You have a background. You have a track record. You have shown that you understand these problems very well. You've come before this committee often and been questioned, and I'm just delighted that the President has recommended your appointment.

You were recommended by the previous administration in 1969, was it?

Mr. MARTIN. Yes, sir, 1969.

Senator PROXMIRE. And I think the other remarks about your background, that you've had a solid small business experience is very helpful and very good. But, frankly, here's one Senator who's for you because you have the right qualifications for the Federal Reserve Board at this time who's faced with tremendously complex, difficult, challenging professional kind of decisions and competence. You bring to the Board that kind of ability.

So I think President Reagan has done himself proud in appointing you and I think you're going to be a fine Governor of the Federal Reserve Board.

The CHAIRMAN. I'm a little bit worried now, with such an enthusiastic endorsement, after 7 years of seeing my good friend, Bill Proxmire, just chew on most nominees for anything. I'll have to reevaluate. [Laughter.]

Very seriously, I want my friend from Wisconsin to know that I don't support Preston Martin only because he's from the West, because if that had been the qualification I would have insisted on somebody from Utah. He does have the qualifications. I don't mind too much that he has a Ph. D. in economics. If he had been both an

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attorney and had a Ph. D. in economics, then I would have had trouble with that.

Mr. Martin, you're an excellent nominee for this position and before you start your testimony, if I could have you stand and be sworn.

[Whereupon, the nominee was duly sworn.]

The CHAIRMAN. If you would like to proceed.

Mr. MARTIN. Thank you, Mr. Chairman and Senator Proxmire. I have no written statement, Mr. Chairman, as you know. I want to indicate my great satisfaction with the opportunity to appear again before this committee. I have not had that privilege since 1972, but as Senator Proxmire indicated, I have had the opportunity to appear before the committee many times in the past. I am, of course, deeply honored that President Reagan has selected me for the dual position of the membership on the Board of Governors of the Federal Reserve and as Vice Chairman and I'm certainly open to any questions at this time, sir.

The CHAIRMAN. Thank you very much.

It is my understanding that you resigned from your position as chief executive officer for Seraco in November 1981 and as a board member in December 1981; is that correct?

Mr. MARTIN. Yes, sir. That's correct.

The CHAIRMAN. I understand that you have already resigned from your position as a board member for various companies. Could you specify which boards you have resigned from?

Mr. MARTIN. Yes. Mr. Chairman, I have resigned from the Seraco Enterprises board, from the Sears Roebuck & Co. board, from PMI Mortgage Insurance Co. board, and the other companies that Senator Hayakawa mentioned as part of the PMI group, from Allstate Savings & Loan Association, from Allstate Enterprises Mortgage Co., and from Executrans.

The CHAIRMAN. You also plan to resign from the President's Housing Commission if confirmed?

Mr. MARTIN. Yes, sir. If confirmed, I will resign.

The CHAIRMAN. And how about the International Conference of Shopping Centers?

Mr. MARTIN. Yes, sir. That is a trade association from whose board of trustees I will resign if confirmed.

The CHAIRMAN. I have been advised that Sears, in appreciation of your past services, will make a lump-sum severence payment and a 1981 bonus payment to you. Is that correct?

Mr. MARTIN. It is correct that my severence will take the form of a lump sum-payment if I'm confirmed. The bonus for 1981 results of the companies for which I formerly had responsibility has already been paid.

The CHAIRMAN. Additionally, you receive pension benefits for which you will be fully vested beginning January 1, 1984, after you turn 60, but you have the option of receiving such pension payments monthly or in a single lump sum. You will also participate in a Sears executive group life insurance plan and have the option of participating in Seraco's group medical insurance plan both at no cost to you. Is that correct?

Mr. MARTIN. That is correct.

The CHAIRMAN. Do all of these arrangements arise out of your past work for Sears?

Mr. MARTIN. They do, sir.

The CHAIRMAN. Are the amounts in terms of these arrangements contractually fixed and unalterable?

Mr. MARTIN. Yes, they are.

The CHAIRMAN. It's my understanding that you will seek a waiver determination from the Chairman of the Federal Reserve Board regarding the Sears vested pension group life and medical insurance plans so you may take part in general policy decisions of the Board in which Sears may have an interest. It's my further understanding that the General Counsel and the Federal Reserve ethics official will recomcomend that such waiver be granted. Is that correct?

Mr. MARTIN. That is corrected.

The CHAIRMAN. Nevertheless, do you agree to recuse yourself from matters before the Board where Sears is either a named party or has a direct and identifiable specific interest?

Mr. MARTIN. I do, sir.

The CHAIRMAN. With regard to your Sears stock, it's my understanding that you and your wife will dispose of all Sears stock and stock options if you're confirmed. Is that correct?

Mr. MARTIN. I will, sir.

The CHAIRMAN. As to your Sears stock which is presently restricted, will you also dispose of that once the restriction is removed?

Mr. MARTIN. I will, sir.

The CHAIRMAN. When will that restriction be removed enabling you to sell the stock?

Mr. MARTIN. The compensation committee of the board of directors of Sears Roebuck met on March the 22 and agreed to release those shares from escrow and remove the restrictions therefrom and as soon as I am in possession of those shares I will divest of them.

The CHAIRMAN. Are you eligible or entitled to any other payments from Sears or any other concerns for past services?

Mr. MARTIN. No, sir.

The CHAIRMAN. I have been advised that you have already sold all of the stock you hold in banks or bank holding companies and your wife will sell her remaining bank stock if you're confirmed. Is that correct?

Mr. MARTIN. That is correct.

The CHAIRMAN. Additionally, it's my understanding that you and your wife will divest yourselves of all stocks which either of you may personally hold in companies which, in the opinion of the Federal Reserve, would create even an appearance of a conflict of interest due to the fact the company's business is involved in financial services.

Mr. MARTIN. We will, sir.

The CHAIRMAN. Will you and your wife sell any Treasury notes which are personally owned by you if confirmed?

Mr. MARTIN. Yes, sir.

The CHAIRMAN. Will you divest yourself of any other security which, in the opinion of the Federal Reserve, may create an appearance of conflict of interest if retained?

Mr. MARTIN. I agree to do that.

The CHAIRMAN. According to your financial disclosure, your wife is a beneficiary in two separate trusts which hold Treasury securities.

Do you or your wife have any control of the investments made under those trusts?

Mr. MARTIN. No, we do not, sir. In the past we have attempted to advise the trustees and have had absolutely no impact on their decisionmaking whatsoever.

The CHAIRMAN. Is your wife the only beneficiary under those trusts?

Mr. MARTIN. No, sir. Her sister, Eloise Martin is likewise a beneficiary.

The CHAIRMAN. In your confidential statement to this committee you have disclosed that Sears Bank & Trust Co. and Manufacturers Hanover Trust have both issued letters of credit on your behalf. It's my understanding that these letters serve as guarantees for promissory notes which you personally executed in connection with investments and do not represent outstanding lines of credit which can be drawn down in the future. Is that correct?

Mr. MARTIN. That is correct.

The CHAIRMAN. Is Sears Bank connected with the Sears Co.

Mr. MARTIN. It is not. It is located in the Sears Tower in Chicago which gives it certain marketing advantages, but it has no corporate relationship.

The CHAIRMAN. In summary, you're agreeing that you not participate in any activity or hold any assets that might be in conflict with your position at the Federal Reserve Board, that you will recuse yourself from matters which would have the appearance of any conflict?

Mr. MARTIN. I do, sir.

The CHAIRMAN. If confirmed, do you agree to appear before this or any other congressional committees when requested?

Mr. MARTIN. Yes, sir.

The CHAIRMAN. Thank you very much, Mr. Martin. We appreciate your candor in answer to those conflict of interest questions.

Senator Proxmire.

Senator PROXMIRE. Mr. Martin, there's another reason why I think it's so good that you're being appointed, and that is that there's no industry that's more credit sensitive than housing. No industry has taken more of a beating than housing in the last several years, particularly in the last several months. As you know, housing starts are down to less than 1 million a year annual rate and that means we will lose about 2 million jobs a year in that one industry.

We had a hearing just yesterday in which it was pointed out again and again that housing has led us into the recession and can lead us out of the recession. The policies of the Federal Reserve Board have a profound effect on housing. Nobody has had better experience that I know of who will serve on the Board than you have. You have been Chairman of the Home Loan Bank Board whose function it is to regulate the savings and loans which in turn finance housing. So that you're in a critical position to be helpful.

Let me put it this way. Yesterday we had a hearing on the Lugar bill. You may or may not be familiar with that. That's a bill that would provide for a substantial interest rate subsidy for new housing to be subsidized to the extent of about 4 percentage points. In other words, get a 17-percent mortgage down to 13 percent, and in

that way provide a substantial stimulus for housing, and the amount provided would, in the calculations of Senator Lugar, give us about 400,000 housing starts which would cost, I calculate, about $26 billion in additional credit.

Now the difficulty with that is if the Federal Reserve Board fails to accommodate that additional credit, it can only have the effect, it seems to me, of crowding out other borrowing, especially other housing, but also automobiles and others.

How do you view that, the effect of a new congressional program which has very substantial support and may be enacted into law, would provide subsidies of 400,000 new homes, and calculations are, if it works fully, with no net loss, could create almost 800,000 new jobs? What's your feeling, first, about the legislation and, second, would the Federal Reserve Board react in any way to that initiative by the Congress?

Mr. MARTIN. Well, Senator Proxmire, I will certainly agree with you entirely with regard to the depth and breadth of the impact of both today's economy, the recession, and with regard to high interest rates and the availability of credit flows in the economy. As a former homebuilder, I'm greatly aware that not only is the unemployment rate in construction perhaps the highest—at least one of the two highest, unemployment rates in industry, but that, furthermore, if you contemplate our small business problem in the country, small businessmen are literally failing by the thousands. It's a failure rate that is at a historic high and, of course, the typical homebuilder is a small businessman. His wife keeps the books. His pickup truck is what they use for recreation on the weekend and so forth. So it is a grave, serious problem.

As you have described Senator Lugar's bill, I see the advantage in that the "buying-down," as is said in the trade, of the mortgage rate is a common commercial practice. It has been the way in which, frankly, the sales of new completed dwelling units have had some "up" months. Without the buying down by builders and joint venturers we would have had a flat, low housing sales curve recently. So buy ng down has the advantage that it comes out of our positive experience, as a way of moving the product, if you will—merchandise, particularly the merchandise to the younger first-time homebuyer, that being a segment of our population that's suffering very much from their inability to finance.

As to the Federal Reserve's accommodation of such credit, however, I feel that buy downs constitute a practice which has worked entirely privately, a practice which I don't relate to credit for automobiles and durables of various kinds. I don't know in my own experience as a homebuilder, as a joint venturer homebuilder, at Allstate Savings & Loan, that we detected any of that relationship. It may exist. I simply haven't detected it. I don't believe that the substantial, deep responsibility of the Board of Governors has to combat inflation, which can be argued to be its paramount responsibility, its unique responsibility among the various Government agencies, needs to be sacrificed in any way. I don't believe there needs to be, let us say, a change in the intermediate monetary targets to accommodate such a bill.

I think that if it is passed it will work—that is to say, the Lugar proposal will work, and I don't believe it would require the Fed to in any way change——

Senator PROXMIRE. That's an assertion, but does it make any sense? The Fed determines the availability of credit in the long run and in the fairly short run even.

Mr. MARTIN. Yes, sir.

Senator PROXMIRE. Now if the Fed does not change its policies and the Lugar bill provides for an increase of $26 billion in additional demand for credit, why wouldn't that drive up interest rates and in the process discourage other homebuilders or home buyers from getting into the market, and why wouldn't some of that probably spill over because it would lift the whole level of interest rates? You see what I'm saying?

Mr. MARTIN. Yes, sir, I see what you're saying.

Senator PROXMIRE. If there's no accommodation by the Federal Reserve Board, it seems to me you're stuck with a particular specific level of available credit. There's no way you can wave a wand or Congress can take action, and come up with $26 billion without the Federal Reserve Board providing some give here. I think you state the case very well. It's an agonizing choice here because the Fed is the only anti-inflation game in town. I have consistently supported the Fed's position because I think we have to pay that rough price.

On the other hand, we now see a situation where in home building we are operating at less than 50 percent of capacity. A stimulus would not therefore be inflationary. You could take 400,000 housing starts and they could do that easily, it seems to me, in all likelihood over a year's period without raising the prices, without even stopping the prices from falling, because you would still have the level of housing starts that would be well within the capacity of the industry. It would put more people to work. But I don't see at this level of capacity, this level of operations, that you would be putting inflationary pressures on the economy, and you would be putting people back to work.

Now as I understood your answer, it was that the Fed should not accommodate this increase from the Lugar bill at all. Then it would seem to me that I can't understand how it can work. Can you explain to me how it can work without any increase in the availability of credit?

Mr. MARTIN. I think, Senator, that particularly with the progress that has been made in inflation in the recent 4, 5, or 6 months, that the growth in the nominal gross national product and the increases in flows of funds within our whole financial system is so enormous and has the potential of bringing in foreign funds at the tremendously high level of interest rates in this country, that there's enough liquidity in the system to accommodate substantially more credit over time—because the $26 billion would not be a shortrun impact; it would take a while. As a former builder, let me tell you, it takes a while for us to gear up for these things. I believe there's enough liquidity in the system that investors would buy these mortgages in lieu of some other investment.

Senator PROXMIRE. Well, I hope and pray you're right, but it just seems to me that it is clear, with the enormous deficits we have been running, with the huge national debt, with the fact that the Federal Government took $1 out of $6 of new savings in 1970–71 when you were Chairman of the Home Loan Bank Board and this year it will take $1 out of $3, and next year the calculations are that it will take

almost $1 out of $2, that any new invasion of that credit market by the Federal Government—and this would constitute that because it would be a federally supported operation—would crowd out other credit that otherwise would be available.

Mr. MARTIN. I think the Senator is particularly referring to 1983, 1984, 1985, the outyears. I have no quarrel with the crowding out that very large deficits threaten, an add on a new mortgage credit program on top of very large deficits——

Senator PROXMIRE. Aren't we doing exactly that in the Lugar bill?

Mr. MARTIN. I must admit that my answer was short run. I was thinking of the immediate impact of the Lugar bill in 1982 and early 1983 before the funds are crowding out in the degree that you have rightly indicated would occur.

Senator PROXMIRE. Well, my only problem is that the level of interest rates right now is a reflection of the crowding out at the present time.

Let me go on. To what extent do you think the Government deficits are responsible for high interest rates?

Mr. MARTIN. I think the expectation by market participants of future deficits is probably the No. 1 factor in today's very, very high real interest rates.

Senator PROXMIRE. How much emphasis would you place on solving our economic problem on balancing the budget, cutting expenditures, increasing taxes, each in turn? First, balancing the budget.

Mr. MARTIN. I think that material reductions in the outyear budget deficits would be the most important thing that any group of individuals or institutions could do. I think that cutting expenditures would come second in any kind of a hierachy. The expenditures not only crowd out in financial markets but crowd out in real markets for real resources.

I think reversal of tax cuts is a much more complicated question—which tax cuts, what are the relationships with regard to incentives it's a much more difficult one to answer, as the Senator knows.

Senator PROXMIRE. My time is up, Mr. Chairman.

The CHAIRMAN. Mr. Martin, first, may I insert in the record three letters in your behalf; one from the President of the National Small Business Association—it's known as the voice of small business—who actively support your nomination; and also one from Mr. Albert Sussman, International Council of Shopping Centers, also from the National Association of Home Builders in support of your nomination.

[Copies of the letters follow:]

NATIONAL SMALL BUSINESS ASSOCIATION,
OFFICE OF THE PRESIDENT,
March 19, 1982.

Hon. JAKE GARN,
Chairman, Senate Committee on Banking, Housing, and Urban Affairs,
Washington, D.C.

DEAR MR. CHAIRMAN: The National Small Business Association is pleased to endorse the President's nomination of Preston Martin to serve on the Board of Governors of the Federal Reserve System.

Mr. Martin has a sound history of small business experience having owned and operated a small business of his own during the 50s and 60s, therefore he is well attuned to the hardships and problems involved in having to meet a payroll. His subsequent service as chairman of the Federal Home Loan Bank Board,

followed by further experience as an independent businessman prior to being bought out by Sears, has added to his knowledge and understanding of the interest rate sensitive sectors of our economy. Based upon his experience, we believe Mr. Martin will be a valued and dedicated Governor of the Federal Reserve System and further that he will be responsive to the needs of the small business community. Mr. Martin fits the requirements of the resolution passed by the Senate which calls for the next appointment to be filled by a person with small business or agricultural experience.

It is our firm hope that Mr. Martin will be quickly and enthusiastically confirmed by the Committee and the full Senate.

Sincerely,

HERBERT LIEBENSON.

INTERNATIONAL COUNCIL OF SHOPPING CENTERS,
New York, N.Y., January 8, 1982.

Hon. JAKE GARN,
Dirksen Senate Office Building,
Washington, D.C.

DEAR SENATOR GARN: I urge you to consider favorably the nomination of Preston Martin as vice-chairman of the Federal Reserve Board when it is officially presented to the Committee on Banking, Housing and Urban Affairs.

Mr. Martin is a member of the Board of Trustees of the International Council of Shopping Centers, a trade and business association of more than 10,000 members who develop, own, operate and invest in shopping centers: own and operate chain and independent retail and department stores, and provide professional consulting and business services to shopping centers. He has been a leader of our industry and, as chairman of the Seraco Group of Sears Roebuck and Company, has exercised prescient, highly informed and insightful judgments.

He is a brilliant analyst of business issues, a warm, human executive and a carefully reasoned decision-maker. I have unqualified admiration for him as a person and for his professional talents. He has bridged the very best of the academic, public service and business spheres in his professional and personal career and should make outstanding contributions to the stabilization of our monetary and economic system on the Federal Reserve Board.

I am sure his appointment would be endoresd by our members and I am confident that he will bring to the Federal Reserve Board a point of view and frame of reference that should earn overwhelming confidence among the leaders of the business community of our country.

Sincerely yours,

ALBERT SUSSMAN,
Executive Vice President.

NATIONAL ASSOCIATION OF HOME BUILDERS,
Washington, D.C., April 2, 1982.

Hon. JAKE GARN,
Chairman,
Banking, Housing, and Urban Affairs Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of the more than 114,000 members of the National Association of Home Builders (NAHB), of which I am President, I urge you to support the President's nomination of Preston Martin to be a member of the Board of Governors and Vice Chairman of the Federal Reserve System. Mr. Martin brings a wealth of experience and talent to that position and would, in our opinion, be a critical asset to the Federal Reserve System. We respectfully request that this letter be made a part of the hearing record.

Mr. Martin's career has spanned many high level positions of importance to housing and finance. He served as Commissioner of the California Savings and Loan Department from 1967 to 1969 and as Chairman of the Federal Home Loan Bank Board from 1969 to 1972. Mr. Martin is a former member of the Federal Home Loan Mortgage Corporation Advisory Committee and serves on the Advisory Boards of the Joint Center of Urban Studies at MIT-Harvard University and the Wharton School of Business.

Mr. Martin has also proven to be an innovator in the area of mortgage finance. He founded, organized and staffed Seraco Enterprises, a Sears, Roebuck holding company that provides capital and overall planning of real estate and financial subsidiaries. For over twenty years, he was involved in home building and mort-

gage finance and created one of the first private mortgage insurance companies small businesses and housing finance as Vice Chairman of the Federal Reserve Commission on Housing.

NAHB believes that Preston Martin will provide excellent representation for small businesses and housing finance as Vice Chairman of the Federal Reserve Board. We again urge your support for his nomination.

Sincerely,

FRED NAPOLITANO,
President.

The CHAIRMAN. Let me follow along the line just for a moment that Senator Proxmire was proceeding on about the overall economic and budgetary problems.

As I have analyzed the situation, it seems to me that although Congress has certainly done a good job of cutting discretionary programs the last couple years by some $50 billion, in my assessment of the long-term money markets we simply have not yet faced the problem of those outyear deficits because to them, those who make long-term loans, 30-year mortgages, that's the year 2012. So when we talk about the outyears of 1983, 1984, and 1985, that's tomorrow to those who are in the long-term lending business.

So essentially where we have taken this $50 billion from is the so-called discretionary programs where we have maintained annual appropriations control and the Appropriations Committee decides how much money will be appropriated for those.

Most of the budget growth is in the so-called "uncontrollables" where the authorizing committees have created automatic indexes, automatically increasing programs, and here we're getting into the so-called political untouchables in the entitlements. When people talk about entitlements, they very rarely say social security, veterans' pensions, Federal civil service, where most of the entitlements are, and where most of the growth has occurred.

In very round numbers, what we have accomplished is cutting about 47 percent of the budget by 8 percent compounded per year, and that's commendable and I voted for those cuts, but in approximately 53 percent of the budget it's still increasing at 16 percent compounded per year. Nobody has to be too smart to figure out that if more than half the budget is increasing at 16 percent and less than half is decreasing at 8 percent, it isn't ever going to balance. With all of the rhetoric going on in this town about things we ought to do to reduce those deficits, not too many people are talking about—the only way you're going to do it is in that 53 percent. If you did away with the third year of the tax cut, as many people talk about, do away with half of it this June, and took $220 million this year out of the military budget—most every proposal you hear floating around—you still wouldn't balance the budget, not with more than half the budget growing at that rate. And you're not even talking about the outyears.

It would seem to me that even if, through accommodation of tax increases and expenditure cuts we balance the budget in 1983 or 1984, interest rates would still stay up very high, at least long-term interest rates, looking to that late 1980's and early 1990's and the year 2000.

So it seems to me that it's just a bunch of rhetoric in this town, (which we never have a shortage of) until Congress really comes to grips with the automatically increasing programs and has the courage

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to tell people even on social security that we're not going to cut your pension—nobody is going to be eliminated—but we are going to slow the growth.

To be specific, if there's a 10-percent CPI increase, we may decide maybe we can only afford a 5-percent increase that year. So I want to make it very clear I'm talking about slowing the increase, showing the long-term money market managers that those deficits in those out years are trending downward, that we are really going to get a grip on that explosion in that half of the budget.

My question is, in that whole scenario, do you agree with that? Is that where on the fiscal side we have to get control and quit playing games with less than half the budget in these discretionary programs, until we have the willingness to slow that growth in the entitlements program, are interest rates going to stay high?

Mr. MARTIN. I think it is a question of the appropriateness as a potential member of the Board of Governors responding in detail to a question which lies so much in the purview and province of this deliberative body.

The CHAIRMAN. We don't hesitate to interfere with the Fed. I don't know why you should hesitate to interfere with us.

Mr. MARTIN. I have no basis on which to quarrel with the Senator's arithmetic and analysis.

The CHAIRMAN. Without going into detail, just in general, would you say that that 53 percent of the budget is a problem, without saying specifically what ought to be cut or how much, in order to bring interest rates down we have to face up to that problem?

Mr. MARTIN. I have no hesitation to agree with you 100 percent, sir.

The CHAIRMAN. Well, I would hope not only in Congress but this administration would start having the courage to face up to that because in this case neither the administration nor Congress has been willing to do that.

Various proposals have been made for using the Federal Reserve discount window to direct credit to certain purposes or industries. How would you evaluate the proposals for using the window for these purposes rather than just to provide temporary liquidity to financial institutions?

Mr. MARTIN. I think, sir, that it is so important that policies be pursued by the Nation's central bank to combat inflation and that the course of decreasing the growth in the money supply, however defined, be held steady, that to layer on top of that most fundamental responsibility—mandate—a differentiation at the discount window, industry by industry, leads to an inappropriate use of the discount window.

The basic job is so important to do, that to have the Board of Governors or some of its staff indicate that industry "A" is worthy and industry "B" is not worthy I think would be an impossible task to perform, No. 1; and, No. 2, it would be diverting from the basic job of controlling inflation.

The CHAIRMAN. I agree with you.

For what purposes do you believe thrift institutions should be allowed to borrow at the discount window?

Mr. MARTIN. I believe that the extended credit program that is now in place in which the local regional Federal Reserve Bank

backs up the local regional Federal Home Loan Bank is an appropriate use. There are times in which the consolidated obligation issuance by the Federal Home Loan Bank System runs into market difficulties. If that is coterminus with the need for substantial liquidity in some part of the country, I would think that the Fed should be—for institutions that are viable, should be a backstop to the Federal Home Loan Bank System.

The CHAIRMAN. What is your evaluation of each of the following proposals? No. 1, the return to contemporaneous reserve accounting from the current lag reserve accounting system?

Mr. MARTIN. As an operating officer of various kinds of institutions, my response to that, sir, is that I'm looking forward to the opportunity to review both the substantial volumes of comments—as the chairman knows, this proposal in two forms has been out and comments have come back in—and the kinds of analyses that bear on that subject.

My mind is completely open as to how the reserve activities should operate.

The CHAIRMAN. How about implementation of the market oriented discount rate?

Mr. MARTIN. I think the same comment. I believe those two subjects are quite intimately related.

The CHAIRMAN. How about stopping collecting and reporting weekly M1 figures?

Mr. MARTIN. Well, as a person who used to be on the borrowing side of the world in very heavy amounts, I could never understand all the fuss about those weekly figures. In the first place, as an ex-teacher of statistics, I don't see how you can get seasonally adjusted annual rates from weekly figures. They are not nonsense certainly. They are not noise. They are real, but what they mean I don't think anybody has the slightest idea. Any kind of improvement in the Federal Reserve's communication to the world as to what's happening to money growth and reserves surely would be good.

The CHAIRMAN. You know, I've yet to ask any witness before this committee that hasn't essentially said the same thing. Some of them have been more specific. They say it's ridiculous and they're inaccurate and they're meaningless. A panel of experts sitting here says that and I ask, "Why do you use them?" And they said, "Well, because that's all there is."

I was at an international monetary conference in London a couple weeks ago and I asked the same question there and all the British and French and German bankers said they're ridiculous. I said, "Why do you put meaning to them? Why do you use them?" I got the same answer. Everybody agrees it's ridiculous, that you can't seasonally adjust them, and yet we continue to do it. I have yet to find a subject since I have been in the Senate that everybody agrees doesn't make sense but we continue to do it.

So I expect to introduce a resolution in the Senate this week or by next week at the latest to say stop doing it, just the sense of the Senate, to see if I can maybe get everybody to quit doing what they all say is ridiculous. It's sending out false signals. I'll find out if the majority of the Senate agrees with me that we ought to stop something that's ridiculous.

What is your view of the relative importance of controlling the monetary aggregates as opposed to controlling interest rates?

Mr. MARTIN. I feel that the change of procedure which was instituted in 1979 is certainly in the right direction. We all are suffering under the current level of rates and we all are coping with the tremendous variability in market rates that is going on. I feel that diverting the Fed's energies to a greater emphasis on rates as a basis of controlling the money supply rather than focusing on the current emphasis on total reserves and on borrowed reserves would be a step in the wrong direction.

The CHAIRMAN. Once again, proposals are circulating for reducing the Fed's independence. Some have proposed that we make the Chairman and Vice Chairman's terms coincidental with that of the President. Some would provide for the Chairman and Vice Chairman to serve at the pleasure of the President. Others would put the Federal Reserve under the Treasury Department. There are numerous variations of these proposals. Alternatively, instead of giving the executive branch more control over the Fed, there have been other proposals to give Congress more say over the day-to-day implementation of monetary policy. That is not new either. There have been actual legislative proposals since I have been here to mandate the range of monetary aggregates for a particular year.

How would you evaluate any of these proposals to take away independence of the Fed either to Congress or to the administration?

Mr. MARTIN. Mr. Chairman, I believe that the independence of the Fed has served this country well over the years. I feel that the current oversight by this committee and by the House committee and by other committees in the two Houses of Congress is working.

I think there is a substantial flow of information and testimony from the Chairman of the Fed and from the members of the Board of Governors, I feel that the working relationship between the Federal Reserve, Treasury, the administration, and the Congress is functioning.

I believe, if you look back in history, the flow of information and the interface among these institutions and organizations I've mentioned is unparalleled. I think one cannot find such interface in foreign central banks and their administration and treasury officials.

I think we have a working system and I'm strongly in favor of the independence of the Fed. I observed that the President in February reiterated his support for the independence of the Fed. If anything, the Congress should be alert to those instances in the history of the central bank in which the Board of Governors has been too responsive to political pressure.

The CHAIRMAN. Well, I would certainly agree with you. Even though many times I have been highly critical of the Fed and some of its decisions, I certainly do not want to turn that policy over to the whims of politics. I doubt if there's ever been a better snow job done by Congress than using the Fed as a scapegoat for all the economic problems of this country. I go home and go across this country and hear just do something to the Fed, change their makeup, make the President to be able to appoint them, let Congress dictate, and everything will be cured overnight and we'll have low interest

rates. It's amazing we have been able to get away with that while obscuring the real culprit, because no President ever spent a dime not appropriated by Congress. No Fed ever monetized part of the national debt that wasn't overspent by Congress.

People tend to forget that the Constitution gives the appropriation authority only to Congress. But we have done one heck of a good job of blaming Presidents and the Fed when I think 99 percent of the problem is right here within our own fiscal policy.

So even though I have been highly critical of the Fed, I certainly don't want to turn over monetary policy to the burglars who have destroyed the fiscal policy of this country over the years. I think hindsight can tell us how bad Congress fiscal policy has been and certainly to have us dictate monetary policy would be bad.

So I support your position. Even though I may yell at you from now and then, I will still support your independence to do something I think is dumb.

Nothing has contributed more to holding interest rates up than financial markets' lack of confidence that the Federal Government will stay on course in implementing the anti-inflationary monetary and fiscal policies.

Now many people, including some Members of Congress, are urging the Fed to adopt a substantial increase in the 1982 target range for M–1 money growth, and I've said in hearings with the Chairman of the Federal Reserve here before that I would hope they would hit the upper range of their targets—as you know, they have been hitting the lower range—and try to get more in the upper range of their own targets. But some have advocated that we increase beyond the target ranges to make up for the lower end of it that occurred this last year.

I think that would be a serious mistake. It would pump that much money back into the economy. I wonder if you would comment on some of those proposals.

Mr. MARTIN. I think any implementation of such a proposal would take away the credibility of the Board of Governors in its exercise of monetary policy in the form of increasing the targets—deliberately changing or exceeding the targets under the present set of circumstances—we all know that circumstances change and international exogenous events occur and occasionally these changes have to take place. Under the current situation, the current fact, for the Fed deliberately to exceed the upper limit I think would send absolutely the wrong signal to the financial markets around the world and the increase in interest rates would be such that we would get back to the 20- or 25-percent range rather than—the Federal funds after all trades down yesterday toward 13 percent, thank God—the overly high rates that we are dealing with today. I think it would be an outrageous mistake.

The CHAIRMAN. Along with your background in small business, you'll be able to bring to the Federal Reserve Board an invaluable understanding of the thrift institutions and the housing industry as a result of your years as Chairman of the Federal Home Loan Bank Board and your private sector experience in the housing industry.

Now this is a very general question and I would expect just a general answer not going into a great deal of detail, but do you have any recommendations with that background experience for the short

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run? All of us know we've got to have lower interest rates. I would hope that at least parts of my S. 1720 on restructuring the thrift industry and banking industry would be helpful. You responded to Senator Lugar's bill in response to questions from Senator Proxmire, but the big question now is everbody comes in and says that's fine, Senator Garn, we like S. 1720 and we like the future, but what are you going to do for us the next 2 or 3 months? There are a lot of proposals around for deep subsidies, for large bailouts, and so on which in light of the budget situation I can't go along with.

Do you have any recommendations, without being specific, as to any shorter term solution for the problem of the thrifts?

Mr. MARTIN. Mr. Chairman, I think that my response to this is going to sound banal because it has been made by so many of my former colleagues—I hope to be former colleagues—in the housing industry and housing finance. That is, the pension funds remain peculiarly in this country disinvolved, if that's the word, with housing and with mortgage finance and with mortgage-backed securities. And I add that third category in that I'm aware of the size of staffs of pension funds. I have been working on this as a private individual before. I know they don't have large staffs and I know they don't have housing specialized staffs or mortgage specialized staffs. But you have this enormous and growing pool of resources out there and they cannot under ERISA and other—they say they cannot under ERISA constraints and other Federal regulatory and State regulatory constraints invest in these mortgage-backed securities and invest in equities in real estate.

We've got an equity real estate problem in the country too, not to add to the problems of this committee, and I'm encouraged by what I understand—I was not a participant—what I understand was a White House conference with the pension fund money managers. I think anything would be helpful that the administration or the Congress can do to get ERISA—those aspects of ERISA that are impeding investment in real estate equities and, more importantly, real estate residential mortgages by pension funds—they want to do it. At the Miami conference of the AFL-CIO, Bob Georgine said his unions would put $500 million into mortgages. When he went back and talked to his lawyers, they probably said "there isn't any way we can do that."

The CHAIRMAN. The Credit Control Act is scheduled to expire this summer. Would you advocate extending its life or letting it expire?

Mr. MARTIN. While I was doing real estate development for Sears I couldn't help overhearing the impact on Sears Roebuck of sales of soft goods when that act was implemented by the Federal Reserve. I feel that the distortion of resources that occurred was very negative to our economy. I think that many of the people hit by those controls were blue collar folks who were buying things for their families, I think it was the wrong measure, at the wrong time, wrongly implemented.

The CHAIRMAN. Well, I think we have a great deal more proof of that even in that period of time when President "Tricky Dicky" had phase 1, phase 2, and phase 4, in the dislocations we had from that situation of price and wage and credit controls.

Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Mr. Martin, I'm sorry I wasn't here at the outset. If I ask you questions that have already been asked to you, I hope you will understand the repetition.

Mr. MARTIN. Yes, sir.

Senator SARBANES. I'm interested in your view of the relationship between the Federal Reserve Board and the rest of the National Government, the Congress, and the President.

What do you see as the working relationship between the Federal Reserve Board and the Congress, and then separately, the executive branch?

Mr. MARTIN. Senator Sarbanes, I support strongly the sections of the Humphrey-Hawkins Act which direct the Board of Governors to enunciate and report on targeting in its implementation of monetary policy. I believe congressional oversight is vitally important because of the strategic position of the Board of Governors and its 12 banks in economic policy. The Board of Governors is a creature of Congress and it is appropriate that it be supervised in that sense.

The working relationship between the Fed and any administration is one that is a tightrope. It is vitally necessary that coordination occur and it is inappropriate and faulty that direction should flow from Treasury or the White House to a politically independent agency, independent within Government. I'm sorry that I'm being repetitious and I apologize to the chairman.

I believe the present system is working. I believe the communication flows are very substantial and adequate.

Senator SARBANES. How do you envision that that coordination between the executive branch and the Federal Reserve should take place?

Mr. MARTIN. I think it should take place—I'm an operating executive and I've had the good fortune to have had responsibility with more than one company at times. Mayby my analogy is faulty, but I've got to go by my own experience as a businessman.

I don't believe there's any reason why in this country, with our traditions of openness and consultation and communication, that two working bodies—three working bodies—the Treasury, the Fed, the White House—cannot, as Americans, work together, share information, argue with each other, do a little yelling back and forth, as the chairman indicated occurs, and it should occur—that's healthy—and work it out the way we in this country work out everything else.

Senator SARBANES. Well, I'm still not quite clear what that means as far as the relationship should work. Do you think that the President and the Chairman of the Fed should regularly meet in order to discuss economic policy?

Mr. MARTIN. Yes, sir.

Senator SARBANES. Do you think that efforts should be made to pursue the same policy?

Mr. MARTIN. I think that it is vitally necessary, particularly in such troubled times as these, that the policies pursued be coordinated, that to the extent possible the policies fit together and work together, and that objectives are shared. As the President indicated in his February comment on the Federal Reserve, among other things, he endorsed the announced objectives, I think the words were, of the

Federal Reserve for 1982 and the growth in the money supply. That is the kind of coordination I think is appropriate.

Senator SARBANES. So it's your perception that the Federal Reserve Board is presently pursuing a monetary policy that is in coordination or consistent with what the administration would like to see them pursue. Is that correct?

Mr. MARTIN. Yes, sir. It is anti-inflationary. It is in its longer term targeting aimed at reducing the growth in the money supply. Both of those sets of objectives have been endorsed by the administration, including the President.

Senator SARBANES. What is your view of the relationship between fiscal and monetary policy?

Mr. MARTIN. Well, that relationship, of course, is an infinitely complex one. I think one reason why most of the forecasting companies and individuals in the country feel like suicide from time to time is that—and they miss their forecasts almost all the time—is that the interface, the interworking of the two kinds of policies have changed some. Partly this is a function of the huge—of the expectations of the huge deficits that most observers detect, project, year in and year out, almost indefinitely in the future, and partly it is that the implementation of monetary policy is so much in the spotlight.

There was a time when I was in Washington off and on in which the Chairman of the Board of Governors appeared before congressional committees two or three times a year and it was kind of a pleasant kind of getting together of old friends and people working and nobody paid much attention to the Fed, but——

Senator SARBANES. It's not that way anymore.

Mr. MARTIN. No, sir. I recognize that, Senator.

Senator SARBANES. I still am not sure as to what you see as the interaction between fiscal and monetary policy.

Mr. MARTIN. I think that the Federal Open Market Committee in its review of the economy and its work to set the targets for monetary growth year by year must take as one of the first two or three series of data to review the expected expenditures and revenues and revenue enhancement and all those other new buzz words that are being employed here—revenue shortfalls and all the rest of it—as almost a first step in setting monetary targets. You cannot exercise monetary policy without starting with fiscal policy and its probable results—ranges of results.

Senator SARBANES. Do you regard monetary targets as the key figure that the Fed should be concentrating on as opposed to, let's say, interest rates?

Mr. MARTIN. I do, sir.

Senator SARBANES. Why is that?

Mr. MARTIN. I'm a pragmatist, Senator, and looking back over the—I haven't done this in depth I must admit, but skimimng over the results and the implementation of monetary policy over the last few years, I think a case can be made that there have been instances in which to affect interest rates in a particular direction—to keep interest rates from rising at a particular time, that open market activities have been pursued in such a way as to overinflate the growth in the money supply, leading—6 months and 9 months and now it's

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shortening to 4 months to 3 months, to almost instantly—leading to disturbances in the economy which could have been avoided had the stress been less on interest rates and more on the growth of the nonborrowed reserves. I'm just saying from experience monetary policy now ought to work better but nobody knows these things. It's unknowable perhaps. It ought to work better to concentrate on the nonborrowed reserves and less on the Federal funds rate, for example.

Senator SARBANES. In your view, would the interest rate go up or down if the money supply goes up or down?

Mr. MARTIN. Well, sir, it used to be pretty easy to respond to that: One just said, well, when the money supply growth was increased, why then, there was going to be a lot more supply of funds, so rates would go down. Now you get into a kind of mythology. You read those Wall Street letters and they say, well, the money supply went up a lot last week and therefore interest rates ought to go up. You say, well, but isn't that increasing the supply and doesn't that normally put the prices down of any commodity or good; and they say, well, yes, but since the money supply increased a lot, that means that the Fed is going to really have to crunch down on things.

So you get this "never-never" land we're living in now in which supply and demand factors run through this expectational filter and they come out upsidedown at times. So if the markets feel the money supply has been increasing unduly, the odds seem to be interest rates will go up.

Senator SARBANES. Well, it's difficult to act rationally under those circumstances, isn't it?

Mr. MARTIN. As someone who used to try to finance shopping centers and housing, Senator, I never was able to figure out a rational course to follow.

Senator SARBANES. I see my time is up. Thank you.

The CHAIRMAN. Mr. Martin, assuming that we have some success in restructuring the financial services industry, it would seem to me that consideration should be given to restructuring regulators as well. When the subject has been raised in the past it's been suggested many times that the Federal Reserve be stripped of responsibility of regulating the banks and bank holding companies so that the Fed could simply operate on money policy without that other function, giving full attention to monetary policy.

Do you have any feelings about that type of suggestion?

Mr. MARTIN. I have very mixed feelings, Senator, on that. Going back to my experience at the Federal Home Loan Bank Board, there the combination of supervisory responsibilities and mortgage credit responsibilities worked together, and I think most of the time worked pretty well. That is, we were able to deal with regional needs for credit and the overgeneration of credit for that matter through the regional Federal Home Loan Bank. That bank was effective or that bank president—what we called the supervisory agent was effective partly because he was also the banker for the savings and loan he was dealing with in supervisory matters.

So as a practical matter, I think it helps exercising both policies, but I'm openminded about that also. I don't know of my own knowledge that the supervisory regulatory function is interfering with monetary policy, but I don't know it isn't.

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The CHAIRMAN. Well, I'm in the same boat. I have an open mind on it. I don't know the answers either.

Chairman Pratt has suggested greatly expanding the powers of savings and loan service companies. One of the proposed new powers would be to sell and underwrite private mortgage insurance.

Given your background in private mortgage insurance, what do you think of the proposal to allow savings and loan service companies to get into this business?

Mr. MARTIN. I would have no objection to their service corporations as a public interest matter providing this service because such companies would be subject to the same insurance commissioner requirements State by State for capital and for underwriting standards and so forth as anybody else.

The CHAIRMAN. Yesterday the Labor Department announced that in February the annual rate of increase in consumer prices dropped to only 2.4 percent. In 1979 we had 13.3 percent in the same period. In 1980, 12.4 percent. The question I would ask you—and I'm sure that certainly the recession has a good deal to do with that reduction, but would you also feel that, in addition, the Fed's monetary policy and the fiscal restraint exercised by Congress in the last year in cutting expenditures is partly responsible for that too? Was it a combination of all three?

Mr. MARTIN. I think it's a combination of all three. I think that if one looks back historically that those periods of time in which the growth in the money supply was controlled and even reduced, those periods of time in which the financial community believed that the Congress was moving in a more responsible direction in fiscal policy, you had these results. These are not unexpected results.

The CHAIRMAN. Well, some people would have us think that the reduction in inflation has only been a result of the recession and I would hate to think that we have gone through all the pain of the budget cutting as well as the tight Fed monetary policy with no result of that policy at all. So I would hope there's some credit given to the fiscal and monetary policies and not the recession alone.

Mr. Martin, I have no further questions for you today. I think you're an excellent nominee. I think you have responded very well to the questions. As I say, my only reservation is Senator Proxmire's enthusiastic support. I only say that kiddingly and facetiously because of the fact that Senator Proxmire is so enthusiastic. As I say, when he looks at nominees so carefully, you must be the only one we've had in a long, long time that he is so satisfied with. So we thank you for your testimony here today and I would expect no difficulties with your nomination. We will process it in the committee as rapidly as we can and get it to the floor for confirmation at the earliest possible date. Thank you very much.

Mr. MARTIN. I appreciate it very much, sir.

The CHAIRMAN. The committee is adjourned.

[Whereupon, at 11:15 a.m., the hearing was adjourned.]

[Biographical material on the nominee, answers to subsequent written questions from Senator Riegel and additional letters received for the record follow:]

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: MARTIN (LAST) PRESTON (FIRST) _____ (OTHER)

Position to which nominated: Member/Vice Chairman, Board of Governors of the Federal Reserve System Date of nomination: _____

Date of birth: December 5, 1923 (DAY) (MONTH) (YEAR) Place of birth: Los Angeles, California

Marital status: married Full name of spouse: Adrienne May Hatch Martin

Name and ages of children: Pier - 20 Gay - 28 Jeffrey - 30

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Indiana University	Sept. 1948-June 1950	Ph.D. Economics	1952
University of Southern CA	1946-1948	B. Sci. Finance, M.B.A.	1948
University of Oklahoma	1944-1945	none	
Los Angeles State College	1942-1943	none	

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

1973 Premier Performance Award, the Turn Table Builders, N.A.H.B.

1972 Alumni Award, University of Southern California

1971 Construction Industry Award, Engineering News Record

1971, 1970 Management Excellence Awards, White House

1969 Top Performer, House and Home Magazine

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
American Finance Association	none	1950-1967
American Economics Association	none	1950-1967
Lambda Alpha (Urban Economics)	none	1964-present
Beta Gamma Sigma	none	1950-present
Inter. Conf. Shop. Ctrs.	Trustee	1980-present
Lambda Chi Alpha	none	1949-

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

1980-Nov.1981 Seraco Enterprises, Inc., Chicago, IL, Chairman and CEO
1973 1979 PMI Mortgage Insurance Co., San Francisco, CA, Chairman and CEO
1969 1972 Federal Home Loan Bank Board, Wash., D.C., Chairman
1966 1968 Division of Savings and Loan, California, Los Angeles, CA Commissioner
1965 Professor of Finance, Graduate School of Business Administration, University South.Calif., Los Angeles, CA
1960 1964 Director of Executive Programs, University of Calif., Los Angeles, CA, and Professor of Finance, USC
1951 1965 Instructor to Professor of Finance, USC, Graduate School of Business Administration
1954 1965 Economic Research Group, Los Angeles, CA Proprietor
1956 (mid) 1957 Instituto per lo Studio Organizatzione Aziendale, Torino, Italia, (Professor of Finance)
1977 1980 The Wickes Corp., San Diego, Cal., Director
1979 1982 Centex Corp., Dallas, Texas, Director
1980 1981 Sears Roebuck & Co., Chicago, Ill., Director

Director of the following Sears subsidiaries:
Seraco Enterprises, Inc.
Homart Development Company
Allstate Savings and Loan Association
Allstate Enterprises Mortgage Company
PMI Mortgage Company
PMI Mortgage Insurance Company of California
Executrans

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Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

Please see employment record for full time posts held.
Present member, President's Housing Commission
Former member, FNMA Advisory Council
Former member, Federal Home Loan Mortgage Corp. Advisory Council
FHLBB Advisory Committee, 1976
H.U.D. Advisory Committee, "Future of FHA", 1977-1978

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

Contributing Editor, "The Professional Builder", 1974-1979, wrote numerous articles on regular basis

"Principles and Practices of Real Estate", University text, The Macmillan Company, 1959

"The Bureaucrat as Innovator", Report to Management #23 USC, 1970
"Savings and Loans in New Submarkets", Journal of Marketing Research, 1967

"Affluence and Household Liquidity", Journal of Finance and Quantitative Analysis, March, 1966

"Forecasting Southern California Business Conditions", Report to Management #13, University of Southern California, 1965

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

National Reagan for President Committee, mid-1980.

My wife Adrienne was an Alternate Delegate, California Delegation, to the Republican National Convention in 1968.

I served as an "Honorary Delegate", California Delegation, to the Republican National Convention in 1972.

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Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

1978, July or August: Luncheon "Pete Wilson for Governor" (of California), $500.00 Approx.

~~1979, October 31: cocktail party for Ronald Reagan for President, $1,321.00~~

July 9, 1981: Sears Roebuck Political Action Committe, $500.00

Qualifications: State fuliy your qualifications to serve in the position to which you have been named. (attach sheet)

see attached sheet.

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

see attached sheet.

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

No plans whatsoever.

3. Has anybody made you a commitment to a job after you leave government?

No

4. Do you expect to serve the full term for which you have been appointed?

Yes

Attachment, Page 4. Qualifications:

This is to state my qualifications for the position of Member and Vice Chairman of the Board of Governors of the Federal Reserve System. My combination of developing and managing governmental and business organizations is unusual. My experience includes managing several activities of a similar agency, the Federal Home Loan Bank Board, in the formulation and implementation of credit policy (mortgage credit), financial institution supervision (and supervisory mergers), and deregulation.

Most of my working career has been involved with managing small businesses and in the "start-up" phases of ventures, particularly Savings and Loan Associations. My consulting firm The Economic Research Group was active for twelve years in those activities. As a sole proprietor I performed a wide range of activities. Similarly, the founding, staffing, and expansion of PMI Mortgage Insurance Company for eight years and several business cycles in the Housing and Financial Industries taught me about monetary policy's impacts.

My two years at Sears, Roebuck & Co. were ones of responsibility for two small organizations, and three medium sized firms; the planning and restaffing which was accomplished was greatly affected by our outlooks regarding developing monetary, fiscal, and regulatory policies.

Attachment, Page 4. Future employment relationships:

Terminated status as active employee of Sears, Roebuck & Co. on November 17, 1981. Received right to severance benefits through December 31, 1983, and retirement benefits thereafter, but have no obligation to provide any services to Sears, Roebuck & Co. or any of its affiliates or subsidiaries.

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

Terminated status as active employee of Sears, Roebuck & Co., on November 17, 1981. Will receive severance payment of $446,438 prior to taking oath of office and will receive pension benefits from Sears effective January 1, 1984. Will continue as a participant in Sears' non-contributory supplemental life insurance plan for key executives.

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

My wife owns 585 shares of the Cathay Bank, Los Angeles, which will be sold.

3. Describe any business relationship, dealing or financial transaction (other than tax paying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

None

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

None

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

My wife and I will sell our National City Corporation shares and her Cathay Bank shares upon confirmation.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

As a member of the Federal Home Loan Bank Board from 1969-1972 and as Commissioner of Savings & Loans of California from 1966-1969, I was named as a defendant in various civil and administrative actions. To the best of my knowledge, none are pending at this time. No criminal or other proceedings.

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

PRESTON MARTIN
VICE CHAIRMAN

April 5, 1982

Dear Senator Riegle:

I am pleased to enclose responses to the written questions you submitted in connection with my nomination hearing held on March 24.

Please let me know if I can be of further assistance.

Sincerely,

Preston Martin

Preston Martin

The Honorable Donald W. Riegle
United States Senate
Washington, D.C. 20510

1. What differences, if any, do you have with the current conduct of monetary policy by the Fed and what changes would you recommend?

I support fully the basic thrust of current Federal Reserve policy, namely, the persistent application of monetary restraint in order to maintain progress toward price stability and thus lay the groundwork for sustained economic growth. It is my intention to study proposals for changes in the methods used to implement the Federal Reserve's policies--for example, the possibility of contemporaneous reserve requirements. Without having had the opportunity to review in detail the research on these technical issues, including the internal work by Federal Reserve staff, I don't think it would be appropriate for me to take a position on them at this point.

2. What in your opinion are the major issues facing the American banking industry today and how would you propose to address them?

The American banking industry and its regulators face a number of challenging issues today. Under the general heading of "soundness," I think I would highlight the question of capital adequacy. For many institutions, the intensifying competition in domestic and international markets and the erosive impact of inflation has resulted in a significant reduction in capital ratios. This is especially discomforting in an environment in which the risk exposure associated with certain credits seems greater. Bankers must focus their attention on the maintenance of adequate returns on their operations and make sure that their lending margins are consistent with a realistic assessment of their risk-taking.

This traditional problem of bank management must, furthermore, be addressed today against a backdrop of potentially major change in the structure of the financial services industry. Institutional developments to date already have dictated a careful rethinking of balance sheet structures and product mixes, including alternative emphases on retail versus wholesale business and responses to changing regulations regarding branching, international banking facilities, Edge corporations, and interest rates. Questions of possible interstate banking or revisions of bank holding company and Glass-Steagall statutes present additional strategic issues for bankers, as well as for their regulators.

As regards my general approach to the broad issue of banking regulation, it is my belief that, while taking due account of the transitional problems of the thrift industry in particular, we should move as rapidly as possible toward a circumstance in which depository institutions are free--within the bounds of safety and soundness considerations--to respond as their business judgment dictates to changing customer needs. Institutions should be able to provide different combinations of services to customers depending on the individual characteristics of the banks and the segments of the consumer, business, government, or international markets that they can and should serve. An important element of the deregulatory process should be the reduction of reporting burden based on the careful analysis of data needs by the banking agencies.

3. What in your opinion will be the end result of the Fed's tight monetary policy and the President's proposed large deficits?

I think it is crucial that the Congress move boldly to cut back the size of the federal budget deficits now in prospect in the years ahead under current programs. Enactment of deficit-reducing measures for fiscal years 1983, 1984, and 1985 on a scale at least as large as what has been proposed by President Reagan would do much to convince the public that the Federal government is putting its fiscal house in order. The fears of inflationary pressures and persistent financial strains that have weighed heavily on the credit markets would be calmed, setting in motion expectational forces that will lower interest rates, especially in long-term markets, and bolster economic activity.

4. Your ideas about monetary policy are not generally known. Are you a monetarist or do you identify with any other particular school of economic thought?

I do not identify with any particular school of economic thought. The bulk of my professional career has been in the management and development of organizations, both public and private. While I believe one must work from some conceptual framework, my experience has taught me that a pragmatic approach is necessary for sound decision-making--a willingness to examine the strengths and weaknesses of a variety of doctrines, and then to adopt those elements of theory that best meet the tests of the real world.

5. What approach do you think should be taken by the Fed to bring down interest rates in the immediate future?

It is important to recognize that the actions of the Federal Reserve are not the only forces influencing interest rates. I don't think there is any additional step that the System can take that would bring down interest rates immediately--and keep them down. By pursuing its current policy of measured anti-inflationary monetary restraint, the System is taking the most promising action it can to bring about a significant, sustained reduction in interest rates. Substantial--and I believe prompt--relief from the current tensions in credit markets could be achieved by decisive action to reduce the federal government's current and prospective budget deficits and associated borrowing requirements.

6. Professor Benjamin Friedman of Harvard believes the Federal Reserve should change its exclusive focus on the money supply and shift to a "two-target" policy, including both money and credit. He would use total net credit of nonfinancial institutions--business, consumers and government--as his credit target. Superior still, he says, would be a three-target monetary policy, including interest rates as well as money and credit. What do you think of this idea?

I must respectfully defer my answer to your technical question with regard to "two-target" or "three-target" approaches to monetary policy. I would want to have an opportunity to examine carefully Professor Friedman's arguments and evidence, as well as related studies by others--including any internal studies by Federal Reserve staff, to which I have not had access as a private businessman. I might say, as a general matter that, I recognize the practical need to communicate policy intentions with some clarity internally and externally. This is best accomplished by placing primary focus on a limited set of measures.

7. Many people believe that we are in the worst recession since the end of World War II and newspaper columnists are increasingly talking about a possible depression. How serious is the current economic situation in your opinion and what should the Central Bank be doing to relieve conditions?

The current economic decline is serious, but I don't see a justification for talk about possible "depression"--certainly not if one takes as the word's meaning a downturn of the magnitude of the 1930s or in some earlier periods of our nation's history. There are many mechanisms in place to prevent such a continuing, cumulative contraction in activity--a central bank that is keeping the money stock growing and providing liquidity to depository institutions through the discount window, a set of federal supervisory and insurance agencies that deal effectively with the weaker depositories, and a federal budget that contains powerful automatic stabilizers (as well as, in the present circumstances, some scheduled large stimulative steps). Of course, there are sectors of our economy that are deeply troubled today, most notably the auto, housing, small business, agribusiness and thrift industries. On the financial side, I think it is important that some version of the so-called "Regulators' Bill" be enacted immediately to provide the federal regulatory agencies with more tools to deal with failing depositories. To address the problems of housing and other credit-sensitive nonfinancial sectors, it is imperative that the federal government reduce its call on private savings including its "off budget" call and thereby ease the pressures on interest rates.

8. What do you foresee as the major issues in international banking during the next few years?

One major issue in international banking that has arisen and will continue to be an issue in the next few years involves the credit exposure of large banks to developing countries and countries in Eastern Europe. To date the loss experience on such lending has been quite acceptable. However, the combination of debt service requirements, high world interest rates, sluggish growth in the industrial countries, weak commodity prices, and the potential for political instability means that this area requires careful monitoring.

A second issue in international banking is the ability of banks to operate in major foreign markets. The United States traditionally has followed a policy of national treatment where foreign banks are permitted to enter and compete with American banks on roughly equal terms. Many problems in this area were addressed by the International Banking Act of 1978. Not all industrialized countries offer foreign banks the same freedom to enter and compete, and the banking agencies in the United States should continue bilateral discussions and negotiations with those major foreign countries where the access of our banks is limited. On the other hand, although the International Banking Act modified the treatment of foreign banks in the United States, the changes that are taking place in U.S. financial markets suggest that the role of foreign banks will have to be reviewed to ensure competitive equality for foreign banks as laws and regulations affecting the ability of domestic banks to compete in domestic markets and product lines are revised.

A third major international banking issue concerns the Euromarkets and their impact on credit flows, monetary conditions, and bank soundness. These subjects are discussed and analyzed by various international groups, particularly under the auspices of the Bank for International Settlements. Given the likelihood of continued growth of these markets, these matters will have to remain under consideration in the next few years.

9. When you headed the Federal Home Loan Bank Board I gather that you occasionally ran afoul of Arthur Burns who was then Chariman of the Fed. Mr. Burns reportedly did not want S&Ls to become too much like commercial banks. What is your current thinking on this matter and what were your basic differences with Mr. Burns?

My task as FHLBB Chairman was partly one of offsetting the cyclical contractions in mortgage credit flows. While such activities may be viewed as working toward ~~as~~ evening out the sectoral impacts of credit stringency, it could also be argued that they tend to blunt the counter-cyclical thrust of monetary restraint. In addition, in the course of assisting the mortgage market, the FHLB System often has been involved in heavy borrowings, which may exacerbate in some degree pressures on capital markets. These facets of FHLB System activity have from time to time raised issues among governmental departments and agencies whose basic missions differ.

On the more specific issue you note, however, I must say that I'm not in a position to confirm that Ambassador Burns did not want savings and loans to become too much like commercial banks. One of my objectives at the FHLBB was the deregulation of the savings and loan industry, but I was not an advocate of NOW accounts at that time (1969 to 1972) and I do not recall differences of view between myself and then Chairman Burns on the subject of savings and loan liabilities.

I believe that our society as a whole would be the loser if deregulation were to produce a financial system lacking in specialized institutions. I believe that a bank or a savings and loan can specialize in a geographic sense, in serving only its community of domicile; it should have the legal leeway to specialize in a particular industry or group of industries, including housing. Given their present management, their tens of thousands of rather specialized employees, and their huge mortgage portfolios, I do not believe that the majority of savings and loans will become "too much like commercial banks." It's unlikely that most savings and loans will be transformed into heavy business lenders, relying overwhelmingly upon transactions deposits and purely money market liabilities for their sources of funds.

10. Bank representatives have testified before this Committee during the past year that nonbank, nondepository institutions are increasingly entering the banking industry by offering financial services and are taking some of their business. To what extent are banks and nonbanks competing for the same services on an "unequal playing field" and how serious is the problem?

What would you propose to do about it?

Banks and nonbanks such as Sears, Prudential and American Express are competing in a very minor way, at the margin, for consumer and credit-card related services. The phrase "unequal playing field" I do not think is relevant in this context. American Express branches are not commercial banks and do not have insured deposits. Indeed, American Express has attempted to divest itself of its commercial banking activities; Sears has already done so. At this time, the competitive situation is a healthy one in that different kinds of institutions are stimulating the provision of new services to consumers.

I would propose to continue close monitoring of the services provided and consumer response thereto. I would use the favorable results of competition to guide deregulation of commercial banking to widen and deepen that competition.

NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS,
Alexandria, Va., March 30, 1982.

Hon. JAKE GARN,
Chairman, Committee on Banking, Housing, and Urban Affairs, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR GARN: The Committee of which you are Chairman was scheduled to hold hearings on March 24, 1982 on the nomination of Preston Martin to be a member and Vice Chairman of the Board of Governors of the Federal Reserve System.

The National Society of Public Accountants is a national organization representing more than 17,000 independent, self-employed, professional practitioners who offer a variety of accounting, tax, auditing and management advisory services to small business firms and individuals.

We are neutral on the nomination of Mr. Martin to the Federal Reserve Board. However, as a national organization whose members service over four million small businesses across the nation, we must express our disappointment that the Administration apparently did not consider House Concurrent Resolution No. 195 introduced by Representative Byron L. Dorgan, expressing the sense of Congress that the President should fill the 1982 vacancy on the Federal Reserve Board with a person of substantial small business experience.

Sincerely yours,

CARL C. PERRY, *President.*

NORTH CAROLINA HOME BUILDERS ASSOCIATION,
Raleigh, N.C., April 1, 1982.

Senator JAKE GARN,
Dirksen Building,
Washington, D.C.

DEAR SENATOR GARN: Read in the Wall Street Journal that there doesn't appear to be any significant opposition to Preston Martin's appointment to the Federal Reserve Board Committee.

Well, I oppose his appointment, since we don't need another economist, S&L executive or banker on the Federal Reserve Board. We need a small businesseman on the Board.

Sincerely,

J. WATTS ROBERSON, *President.*

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